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No. 85-1298

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

JERRY PAYNE AND DEBORAH PAYNE,
Petitioners,

vs.

CHARLES R. WOOD,
Respondent.

BRIEF OF RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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QUESTION PRESENTED FOR REVIEW

Was the United States Court of Appeals for the Seventh Circuit correct in holding that insurance proceeds on personal property which was not scheduled and therefore *not* claimed exempt under 11 U.S.C. § 522 are properly included as *part of the bankrupt's estate* under 11 U.S.C. § 541, where the debtor received the State statutory limit on exempt property and where the debtor failed to amend his Schedule of exemptions to include reference to such items, even though he knew the Schedule was grossly inaccurate?

LIST OF PARTIES

The parties to the proceeding whose judgment is sought to be reviewed are:

Plaintiff - Charles R. Wood, Jr., Trustee

Defendant - Jerry Payne
Deborah Payne

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STATEMENT OF THE CASE

The Paynes' brief falls short of reciting all of the pertinent facts. Accordingly, Respondent submits the following supplemental statement of facts.

On August 12, 1981, the Paynes filed a voluntary petition under chapter 7 of the Bankruptcy Code. (Order, Jan. 4, 1983). In late 1981, the Paynes made two lists of their household possessions. They submitted the first list to the Bankruptcy Court, listing their personal property exemptions for their B-2 bankruptcy schedules:

Zenith Stereo	8 years old	$ 50.00
G. E. Refrigerator	9 years old	25.00
G. E. Washer	8 years old	15.00
G. E. Dryer	8 years old	25.00
Furniture		615.00
Household Dishes and Small Appliances		100.00
RCA Color Television		250.00
Other Personal Property		125.00
Ford 12 Horsepower Riding Mower		1,000.00

(Order, Jan. 4, 1983, Pet. Br. at A-2). They claimed a total exemption of $1,205.00 for clothing, household goods, furnishings and appliances on their Schedule B-4 (*Id.*).

On December 15, 1981, a fire destroyed the debtors' home and much of their personal property. (*Id.*). After the fire, the debtors made their second list of their personal property. They filed the second list, an extensive and detailed list of property with their fire insurance loss carrier (*Id.*). The insurance list included the following, among other items:

Zenith Stereo	1 year old	206.10
G. E. Refrigerator	3 years old	665.00
G. E. Washer	3 years old	224.37
G. E. Dryer	3 years old	155.62

(Trustee's Exh. B)

The Paynes fail to account for the clear discrepancies between the values and relative ages of appliances as indicated on their B-2 Schedules and as indicated on their insurance proof of loss forms. The Seventh Circuit found: "The Paynes' omissions from the initial list suggest that they meant to hide assets if they could get away with it." *Payne,* Slip. op. (Pet. Br. at A-13).

The Paynes also fail to refer to the following items of personal property which, among others, appeared on the insurance list but were not listed on the bankruptcy schedules at all:

Item	When Acquired	Ref. Found
Penney's color television set	1980	(Trustee's Exh. B)
Zenith radio cassette player	1978	(Trustee's Exh. B)
Black and white television set	1978	(R.7)
Air conditioner	1979	(Trustee's Exh. B)
Gas grill	1979	(Trustee's Exh. B)
Floor stereo	1979	(R.8)
Stereo speakers	1979	(Trustee's Exh. B)
Encyclopedia Americana	1978	(Trustee's Exh. B)
H&R pistol	owned a couple of years	(R.11)
Stalker bow	1980	(Trustee's Exh. B)
Movie projector and camera	1981	(Trustee's Exh. B)

The Paynes admit they "did not list several items which may have been reasonably saleable by the Trustee." *Payne*, Slip. op. (Pet. Br. at A-16). They also stated that the insurance list is a true and accurate description of the personal property destroyed by fire on December 15, 1981. (Trial R.11, line 14). They cite no evidence to explain the discrepancies between the insurance list and the bankruptcy schedules. Nor have they ever explained or sought to excuse their failure to amend their bankruptcy schedules.

At the hearing before the Bankruptcy Court, Mr. Payne gave inconsistent testimony or no testimony at all in explanation of the discrepancies between the two forms. Regarding the movie equipment, he stated: (1) it was purchased *prior* to the bankruptcy (R.6, line 25); (2) it was purchased *after* the bankruptcy (R.41, line 18); and (3) it was purchased *to replace* what he knew would be taken in bankruptcy (R.42). He "didn't know why" the black and white television set was not reported

on the bankruptcy schedule. (R.47, line 5; compare Trustee Exh. B, p. 24). He didn't recall whether there were two stereos (R.47, line 15); only one stereo was listed on the bankruptcy schedule (B-2), while two were listed for fire insurance recovery purposes. (Trustee's Exhibit B, p. 9; p. 24). When asked why he did not report his set of encyclopedias on the bankruptcy schedules, but did report it on his fire insurance claim, he replied his counsel advised him: "If they come in on it later you have to release it. *If they didn't*...if they claim a security in it they had to prove it ..." (R.48, lines 11-15).

There is no evidence that the Paynes ever brought to the Trustee's attention either (1) the items which they disclosed for insurance purposes but did not disclose in bankruptcy or (2) the fact that they had received any monies as actual cash value for the unreported — or for the reported — items which were lost in the December 1981 fire.

In its order of January 4, 1983 at p.3, the Bankruptcy Court implicitly found the Paynes did not fully disclose the nature and extent of their personal property on their bankruptcy schedules. (Pet. Br., A-4) The Paynes appealed to the District Court from the Bankruptcy Court's ruling. In its Order of August 14, 1984, the District Court found the Paynes failed to disclose certain assets on their bankruptcy schedule. (Pet. Br., A-8)

The Seventh Circuit Court of Appeals affirmed, remanding to the district court to include full insurance proceeds for the family's clothes as required under Illinois law.

The Court of Appeals found:

> The Paynes' list did not put the trustee on notice. ... A more accurate listing might have provoked investigation. The Paynes concede that even by their methods of valuation an accurate schedule would have revealed more than $2,000 of assets and that the trustee might well have found

> it worthwhile to take and sell several items. By filing an incomplete form, the Paynes forestalled an inquiry they knew lay in store. The legal result is a limitation on the value they may receive for assets in these categories.

(Opinion, Petitioner's brief, Appendix p. A-16).

Further facts will be referred to below, as necessary to understand the Argument.

ARGUMENT

Respondent Charles R. Wood respectfully submits that the Petition for Writ of Certiorari should be denied. The Seventh Circuit correctly ruled that insurance proceeds for personal property which the debtor did *not claim* as exempt were *part* of the bankrupt's estate. As will be shown below, the debtor already has been awarded sums in excess of that allowed under applicable state statute. In addition, the debtor failed to disclose relevant assets even though he knew the schedule of asserts he filed in bankruptcy was grossly inaccurate.

The long-standing rule in bankruptcy is that all property of the debtor becomes part of the bankrupt's estate at the commencement of bankruptcy proceeding. 11 U.S.C. sect. 541. *See generally, United States v. Whitting Pools, Inc.*, 462 U.S. 198, 103 S.Ct. 2309, 76 L.Ed.2d 515, 521-522 (1983). The bankrupt party has a right to claim certain property as exempt from the estate, under the provisions of 11 U.S.C. sect. 522. Upon the failure of a debtor to claim property as exempt, the property goes to the Trustee for the benefit of the creditors. *In re Friedrich,* 100 F.2d 284 (7th Cir. 1900); *Gardner v. Johnson,* 195 F.2d 717 (9th Cir. 1951); *In re Guerrero,* 30 B.R. 463 (N.D.Ind. 1983). This is true regardless of whether the property *might* have been successfully exempted, had the debtor asserted such a claim. *In re Elliott,* 31 B.R. 33, 35 (S.D. Oh. 1983), *citing* sections 541 and 522(b).

In this case, the Bankruptcy Court first apportioned to the Paynes the $3,664.00 in proceeds attributable to property acquired after their filing of the petition in bankruptcy. The Bankruptcy Court then placed the Paynes' property into one of three groups: (1) insurance proceeds from items listed as exempt; (2) insurance proceeds from durable goods that had been listed only by category, eg., furniture, dishes, and clothing. The property in Group 1 went to the Paynes. Property in Group 2 went to the Trustee. Property in Group 3 went to the Paynes in

the amount listed, no more. The balance of the proceeds went to the trustee. This allocation was clearly within the Bankruptcy Court's broad discretionary power to allocate assets.

I. The Paynes Are Not Entitled To Recover Insurance Proceeds On Personal Property In Excess Of Statutory Limits

The Paynes' first contention, that they should recover additional money for their family's personal possessions and from the proceeds of their casualty insurance policy, must be rejected. As will be shown below, not only have the Paynes received their statutorily allowed exemptions, but they now mistakenly seek to recover insurance proceeds on personal property they themselves did not undertake to disclose or to list as exempt, as statutorily required. The Paynes neglected to list any such insurance in the bankruptcy proceedings, or to disclose such proceeds as they received after the fire.

The relevant applicable Illinois statutory limit on exemptions for the debtor *who is the head of a family* and resides with them is $1,000.00. Ill. Rev. Stat. Ch. 52, Sect.13(c) (1981). This $1,000 limit was expanded by the Illinois legislature to $2,000 in 1982. Ill. Rev. Stat. Ch.110, Sect.12-1001(b). The Paynes are simply mistaken in asserting that the bankruptcy laws fail to account for possessions of the debtor's *family*. On the contrary, sect. 12-1001(b) and its predecessor, sect. 13, specifically provide for such exemptions. The courts below have allowed the Paynes to retain the value of personal property in excess of the $2,000 limit.

Neither Chapter 52 nor its successor, Chapter 110, allows recovery of insurance proceeds in amounts in *excess* of amounts allowed under the statutory exemptions. This may be illustrated by reference to the homestead exemption. The Illinois legislature specifically provided for the disposition of insurance proceeds on property exempted as a *homestead,* stating that "such insurance money shall be exempt *to the same extent* as the building would have been had it not been destroyed." Ill.

Rev. Stat. Ch.110, sect. 12-907. (emphasis supplied.) The legislature did *not* provide for the retention of insurance proceeds on personal property claimed as exempt. See Ill. Rev. Stat. Ch. 110, sections 12-1001 - 12-1005. Accordingly, insurance proceeds on personal property claimed as exempt fall within the section 12-1001(b) exemption for the debtor's equity interest, *not to exceed $2,000 in value, in any other property.* Insurance proceeds in excess of the limits allowed under Chapter 52 and 110 are non-exempt. *See, e.g., Lewis v. Thompson,* 30 B.R. 741 (M.D.Pa. 1983) (Lewis III).

Even if the debtor may retain insurance proceeds up to the exemption limit, the debtor's recovery extends only to the insurance proceeds on *exempt* property; insurance on non-exempt property remains with the Trustee as part of the estate. *Lewis v. Thompson,* 30 B.R. 741 (M.D. Pa. 1983). The facts of the *Lewis* case are analogous to the facts in the instant case in that the debtors there had filed bankruptcy schedules that were inaccurate, and they, too, had a fire in their home soon after filing for bankruptcy. Unlike the Paynes in this case, however, the debtor in *Lewis* promptly amended his bankruptcy schedule when he discovered the disparity between the bankruptcy schedules and his insurance proof of loss forms. Here, the Paynes did not disclose the insurance or the proceeds to the court. Nor did they amend their schedules. Instead, the Paynes undertook the risk to see if the Trustee "would come in on" the inaccuracies, which occurred when the insurance company contacted the trustee regarding disposition of the insurance proceeds.

In *Lewis,* the court held that only insurance proceeds on property exempted by the debtor could be retained, even though there was no finding of fraud in that case. *Lewis v. Thompson,* 21 B.R. 282, *modified* 28 B.R. 351 (reversing finding of fraudulent concealment), *modified* 30 B.R. 741 (limiting debtor to insurance proceeds on exempt property) (M.D. Pa. 1983). Amounts in excess of the State statutory exemption are, by definition, non-exempt.

In this case, the Paynes do not deny that they failed to disclose all of their assets in the bankruptcy proceeding, nor do they deny that they failed to amend their bankruptcy schedules when they made their second list of personal property for insurance claims, and knew that the Schedule B-2 was grossly inaccurate. In addition, the Paynes do not deny that they retained insurance proceeds up to the full statutory exemption under Ch. 52, Sect. 13, as amended by Ch. 52, Sect. 12-1001(b). Since the Paynes received the full exemption allowed — and more — for their insurance proceeds even though they failed to report the policy or the proceeds thereon to the Bankruptcy Court, they should not now be heard to complain.

II. The Decisions Below Do Not Create Uncertainty Among Those Filing Petitions In Bankruptcy As To The Specificity Required In Filling Out Schedules; Nor Do They Impermissibly Impose A Penalty Without A Finding Of Fraud.

The Paynes have mischaracterized this case by challenging the appellate court's decision as a *penalty* for failing to "itemize every dish and fork." Instead, this is a case in which the debtors knowingly undertook to underestimate the value of their goods, to fail to disclose, and to omit items from their bankruptcy schedules altogether. As shown above, the Paynes have received their allowable statutory exemptions. Under Illinois law, they are not entitled to receive more. The facts of this case do not warrant further review.

The Paynes do not deny that the bankruptcy rules define property of the estate and specify what property becomes property of the estate. See 11 U.S.C. sect. 541 (1978). Nor do they deny that 11 U.S.C. sect. 522 permits a debtor the exemptions to which he or she is entitled under other Federal law and the law of the State of his or her domicile, and *requires* the debtor to file a list of property claimed as exempt. Those exemptions in this case are governed by Ill. Rev. Stat. Ch. 52, sect. 13 (1973) amended as Ch. 110, sect. 12-1001 et seq. (1982). *This appeal*

does not involve a challenge to the validity of any of the above cited rules.

The Paynes' contention that the Bankruptcy Court has no authority to issue an order or judgment under 11 U.S.C. sect. 105 finding that assets neither properly disclosed nor claimed as exempt belong to the estate rather than to the debtor, *unless* the court enters a finding of contempt of court, is patently wrong.

The Paynes do not deny their non-disclosure, their failure to amend, or their receipt of exemptions within the applicable statute. The Paynes concede that an accurate schedule would have sold for the benefit of the estate. See Pet. Br. p. A-16. In light of the circumstances, the Paynes have failed to show how the result in this case improperly imposes a "penalty" or in what ways the bankruptcy rules fail to make clear just what they should have reported to the Bankruptcy Court, but did not.

The Paynes should not be allowed to hide behind the "fresh start" policy as a justification for their failure to comply with the very bankruptcy regulations under which they now seek protection. Since the court decided to allow recovery to the Paynes rather than to revoke Paynes' discharge altogether, no finding of fraud was required. As pointed out by the Seventh Circuit in its opinion below:

> The omission of assets may be a good reason to deny or revoke a discharge. 11 U.S.C. sect. 727; Thomas H. Jackson, "The Fresh Start Policy in Bankruptcy Law" 98 *Harv. L. Rev.* 1393, 1440-46 (1985).

The authorities which discuss the rationale behind the fresh start policy clearly delineate between instances such as this, where the debtor admits to withholding information from the trustee, hoping the trustee "wouldn't come in on it," and those instances where the debtor, in full compliance with the spirit and letter of the applicable regulations, honestly seeks to marshall

his debts and assets. Those authorities uniformly hold, as did the Seventh Circuit in this case, that duplicity and withholding of information are contrary to the purposes of the Bankruptcy Code and should not be rewarded.

CONCLUSION

The Seventh Circuit correctly applied the relevant State statute regulating exemptions for personal property and properly held that the insurance proceeds from items not disclosed or not claimed as exempt go to the estate. The Seventh Circuit's decision is not in conflict with other federal courts of appeal or this Court, and does not involve any important question of federal law that requires review by this court. The Petition for Writ of Certiorari accordingly should be denied.

Respectfully submitted,

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